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SIPDIS

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SUBJECT: EXPERT VIEWS ON TURKISH MONETARY AND FISCAL POLICY

REF: A. ANKARA 1045

[B](#). ANKARA 1026

[C](#). ANKARA 996

Classified By: Acting Econ Counselor Rebecca Neff for reasons 1.4 (b) a  
nd (d)

[1](#). (C) Summary. In separate meetings this week with Central Bank (CBRT) and International Monetary Fund (IMF) managers, we heard similar complaints about GOT shortfalls in economic management and fiscal policy. Central Bank Markets Department Manager Cigdem Kose said the CBRT will have trouble managing inflation if the GOT does not limit spending and tighten fiscal policies. IMF Resident Representative Hossein Samiei can see the need for more spending on projects in the southeast (Reftel C), but he thinks there is "no more room" to loosen fiscal policy if the GOT intends to keep inflation and the current account deficit under control. Both officials agree the GOT should decide now about its future relationship with the IMF. The certainty of a decision would allay some investor concerns about Turkey as a desirable investment destination. End Summary.

[2](#). (C) CBRT's Cigdem Kose and her deputy, Emrah Eksi, told us that capital has been leaving the equity and bond markets since January 2008. Stock ownership by foreigners fell from 71 to 68 percent. High real interest rates in Turkey continue to attract carry trade from foreign and domestic investors, creating a net inflow on the currency market.

[3](#). (C) Kose said the CBRT's Monetary Policy Committee (MPC) has been in consultations with the GOT and the IMF for six months and there has been agreement on rate management. Inflation management success in Turkey over the last five years has been achieved when fiscal and monetary policies were tightened in tandem. Since 2004, tight fiscal policy and limits on spending have helped the CBRT achieve its monetary goals and kept inflation under 10%. Most forecasts for year-end 2008 estimate inflation will top 10%. We note that the GOT's decision to decrease the primary surplus target and increase spending will limit the effectiveness of the CBRT as it tries to manage inflation through interest rate adjustments.

[4](#). (C) In a separate meeting, IMF Resident Representative Hossein Samiei and his Deputy Davide Lombardo said the GOT has not yet made any comments or requests for a future relationship between Turkey and the IMF since the existing standby agreement ended May 10, 2008.

[5](#). (C) While there is no deadline or urgency to determine

future relations between Turkey and the IMF, both our IMF and CBRT contacts agree with us that investors would welcome the certainty of ongoing relations via some kind of agreement. A precautionary standby would give the GOT flexibility to borrow, if needed. It would also give the GOT an anchor, specific targets to shoot for, and a fall guy on which to blame tough or unpopular policies. Even if the GOT and IMF don't agree on any future program, Turkey will be subject to post-program monitoring as it repays its existing obligation to the IMF.

¶16. (C) Regarding increased spending by the GOT, Samiei said the IMF agreed to proposed programs, such as for the GAP, as long as the GOT avoided any off-budget spending. The IMF does not see a need for the AKP's proposed massive infrastructure spending or transfers of \$4 billion to municipalities for unspecified projects. Lombardo called these latter projects "wealth creation for AKP financiers". On the subject of revenue collection, Samiei said the tax collectors focus too much on squeezing every penny out of big taxpayers and don't go after the thousands of scofflaws who pay no tax at all. We strongly agree that spreading the burden of a reasonable tax over a much broader base of taxpayers would benefit everyone. The GOT would increase its collections substantially and have money for needed programs. Rule of law would be strengthened by everyone receiving equal treatment.

¶17. (C) On the internal workings of the GOT Economic Team, Deputy Prime Minister for Economic Affairs Nazim Ekren, Treasury Minister Mehmet Simsek, and Finance Minister Kemal Unakitan, the CBRT managers do not see good coordination on economic affairs. Decision making remains centralized with the Prime Minister. In the AKP government's first term of

office, then-Economy Minister Ali Babacan held many technical discussions with the Central Bank and there was more of a teamwork process to economic management. Then-Foreign Minister Abdullah Gul played a key role in economic affairs, and he and Babacan had more leeway to make decisions than the current team. Our IMF contacts agree that there is little to no coordination or teamwork now by the responsible GOT ministers. Samiei said he believes Simsek and Unakitan know what needs to be done for prudent fiscal management, but constant pressure from other cabinet members limits their ability to make the right decisions. The ministers for Industry and Trade, in particular, consistently criticize the Central Bank, opt for populist policies and spending "for growth", and do not understand the tradeoffs needed to keep the budget under control.

¶18. (C) On the issue of GOT appointments to vacant vice governor and MPC seats, non-partisan Kose and Eksi were judicious and had little to say. They did note that the Prime Minister's announcement of a planned move of the CBRT to Istanbul might present an opportunity to do some housecleaning and remove managers who are not AKP supporters. To date, Central Bank Governor Durmus Yilmaz has succeeded in keeping the CBRT independent and non partisan. Despite occasional rumors that he will be ousted, he has stayed the course.

¶19. (C) Regarding the GOT's refinancing of approximately YTL 37 billion (USD 30.8 billion) of debt in July and August, the Central Bankers and IMF believe it will not be difficult to find financing, although they do expect prices to go up significantly since investors will seek a higher risk premium.

¶10. (C) Comment: Reftel B talks about investors becoming increasingly nervous about Turkish assets. We heard the same concerns from Central Bank and IMF officials. The GOT could do itself a favor by talking with the IMF and determining a path forward--sooner rather than later. Delays in making a decision will increase investor concerns about the AKP's resolve to continue with the good money management that won it many more votes in its 2007 reelection. In a period of domestic political uncertainty and global economic weakening, investors are looking for strong signs that Turkish assets

are still safe and desirable. If investors start to leave the Turkish market in big numbers, it will be much harder for the GOT to regain their trust and attract them back. End comment.

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